All of the income leases below are to entities that are related to the Company through common ownership.

1027 Willamette

In July 2017, the Company entered into an operating lease agreement with a marijuana dispensary (the "Lessee") to move into the Company's acquired property located at 1027 Willamette Street in Eugene, Oregon. The lease agreement is for a base term of ten years (see note below) and a monthly rent obligation of $13,800, subject to annual increases of 3% per year, plus an amount for additional rent based on final buildout costs incurred by the Company. The lease is a double net lease with maintenance and real property taxes to be paid by the Tenant and insurance costs paid by the Company. The Company provided the tenant with one month of free rent.

Upon the expiration of the term of ten years, the Lessee has the option to renew the lease agreement for one five-year term, on the same terms as provided in the lease agreement.

Springfield

In July 2017, the Company entered into a lease agreement for its property and warehouse building located at 800 N 42nd street in Springfield, Oregon. The lease agreement is for a term of ten years (see note below) and a monthly rent obligation of $64,640, subject to annual increases of 3% per year plus an amount for additional rent based on final buildout costs incurred by the Company. The lease is a double net lease with maintenance and real property taxes to be paid by the Tenant and insurance costs paid by the Company. Rent payments commence on the date the growing season ends, which the Company currently estimates will occur in September 2019, and thus expects payments to begin in January 2020. The Company has treated this period as a free rental period for accounting purposes.

Upon the expiration of the term of ten years, the Lessee has the option to renew the lease agreement for five-year term, on the same terms as provided in the lease agreement.

14336 S. Union Hall Road, Mulino

In July 2017, the Company entered into a lease agreement for its property located at 14336 South Union Hall Road in Mulino, Oregon. The lease agreement is for a term of ten years (see note below) and a monthly rent obligation of $18,750, subject to annual increases of 3% per year plus an amount for additional rent based on final buildout costs incurred by the Company. The lease is a double net lease with maintenance and real property taxes to be paid by the Tenant and insurance costs paid by the Company. Rent payments will begin at the of the first growing season, which the Company currently estimates will occur in September 2019, and thus payments will commence in January 2020. The Company expects to treat such period as a free rental period for accounting purposes. At the time rental payments begin, the total of base rent and additional rent will not be less than $1.00 per foot for light assisted greenhouse and $.25 per usable square foot for un-light assisted greenhouse or outdoor grow space.

Upon the expiration of the term of ten years, the Lessee has the option to renew the lease agreement for five-year term, on the same terms as provided in the lease agreement.

7827 SE Powell

In July 2017, the Company entered into a lease agreement for its acquired property located at 7827 SE Powell Blvd. in Portland, Oregon. The lease agreement is for a term of ten years and a monthly rent obligation of $6,523, subject to annual increases of 3% per year. Maintenance and real property taxes to be paid by the Tenant and insurance paid by the Company. Additional rents will be added to pay landlord back for tenant improvements by the end of the first term of the lease, payments will include annual interest at 12% compounded monthly. Rent payments commence on the date the growing season ends, which the Company currently estimates will occur in May 2019, and thus expects payments to begin in September 2019. The Company has treated this period as a free rental period for accounting purposes.

Upon the expiration of the term of ten years, the Lessee has the option to renew the lease agreement for five-year term, on the same terms as provided in the lease agreement.

12. Subsequent events

From January 1, 2019 through the date of these financial statements, the Company issued shares of its common stock in satisfaction of compensation provisions within certain consulting agreements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Forward Looking Statements

This Interim Report on Form 10-Q contains, in addition to historical information, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 ("PLSRA"), Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act") regarding Stem Holdings, Inc. (the "Company" or "Stem", also referred to as "us", "we" or "our"). Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Forward-looking statements involve risks and uncertainties. Forward-looking statements include statements regarding, among other things, (a) our projected sales, profitability, and cash flows, (b) our growth strategies, (c) anticipated trends in our industries, (d) our future financing plans and (e) our anticipated needs for working capital. They are generally identifiable by use of the words "may," "will," "should," "anticipate," "estimate," "plans," "potential," "projects," "continuing," "ongoing," "expects," "management believes," "we believe," "we intend" or the negative of these words or other variations on these words or comparable terminology. These statements may be found under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Description of Business," as well as in this Form 10-Q generally. In particular, these include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, the outcome of contingencies such as legal proceedings, and financial results.

Any or all of our forward-looking statements in this report may turn out to be inaccurate. They can be affected by inaccurate assumptions we might make or by known or unknown risks or uncertainties. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially as a result of various factors, including, without limitation, the risks outlined under "Risk Factors" detailed in the Company's Form 10 registration statement and matters described in this Form 10-Q generally. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this filing will in fact occur. You should not place undue reliance on these forward-looking statements. The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to publicly update any forward-looking statements, whether as the result of new information, future events, or otherwise. We intend that all forward-looking statements be subject to the safe harbor provisions of the PSLRA.

For the year ended September 30, 2018, the financial statements have been prepared by management in accordance with the standards of the Public Company Accounting Oversight Board (United States). For the three months ended December 31, 2018, the unaudited interim financial statements have been prepared by management in accordance with the condensing rules of the United States Securities and Exchange Commission.

OVERVIEW

Stem Holdings, Inc. (the "Company") is a Nevada corporation incorporated on June 7, 2016. The Company purchases, improves, and leases properties for use in the cannabis production, distribution and sales industry as well as a cultivator providing cannabis and cannabis-infused products licensed under the laws of the states of Oregon, Nevada, Oklahoma, with six current licenses for cultivation, three for production, five for processing, one for wholesale and ten dispensary licenses. In addition, the Company also procured a hemp license under the laws of Oregon. As of December 31, 2018, the Company has acquired 3 commercial properties and leased a fourth property and has entered into leases to related entities for these four properties.

The Company, through its operating subsidiaries (see below), is currently in the process of finalizing the investment in and acquisition of entities that engage directly in the production and sale of cannabis, moving from a real estate focused entity with a cannabis niche to a vertically integrated cannabis focused entity.

The Company's stock is publicly traded and is listed on the Canadian Securities Exchange under the symbol "STEM" and the OTCQB exchange under the symbol "STMH".

Recent Developments

Under the Obama Administration, the DOJ previously issued memoranda, including the so-called "Cole Memo" on August 29, 2013, providing internal guidance to federal prosecutors concerning enforcement of federal cannabis prohibitions under the CSA. This guidance essentially characterized use of federal law enforcement resources to prosecute those complying with state laws allowing the use, manufacture and distribution of cannabis as an inefficient use of such federal resources when state laws and enforcement efforts are effective with respect to specific federal enforcement priorities under the CSA.

On January 4, 2018, U.S. Attorney General Jeff Sessions issued the Sessions Memo, which rescinded the Cole Memo and related internal guidance issued by the DOJ regarding federal law enforcement priorities involving marijuana. The Sessions Memo instructs federal prosecutors that when determining which marijuana-related activities to prosecute under federal law with the DOJ's finite resources, prosecutors should follow the well-established principles set forth in the U.S. Attorneys' Manual governing all federal prosecutions. The Sessions Memo states that "these principles require federal prosecutors deciding which cases to prosecute to weigh all relevant considerations, including federal law enforcement priorities set by the Attorney General, the seriousness of the crime, the deterrent effect of criminal prosecution, and the cumulative impact of particular crimes on the community." The Sessions Memo went on to state that given the DOJ's well-established general principles, "previous nationwide guidance specific to marijuana is unnecessary and is rescinded, effective immediately."

It is unclear at this time what impact the Sessions Memo will have on the medical-use marijuana industry. In addition, pursuant to the current omnibus spending bill previously approved by Congress, the DOJ is prohibited from using funds appropriated by Congress to prevent states from implementing their medical-use cannabis laws. This provision, however, is currently set to expire on March 23, 2018, and there is no assurance that Congress will approve inclusion of a similar prohibition on DOJ spending in the appropriations bill for 2018. Although we are not engaged in the purchase, sale, growth, cultivation, harvesting, or processing of medical-use marijuana products, we lease our properties to tenants who engage in such activities, and therefore strict enforcement of federal prohibitions regarding marijuana could irreparably harm our business, subject us to criminal prosecution and/or adversely affect the trading price of our securities. See "Business—Government Regulation" and "Risk Factors—Risks Related to Government Regulation."

Results of Operations

The following comparative analysis on results of operations was based primarily on the comparative consolidated financial statements, footnotes and related information for the periods identified below and should be read in conjunction with the audited consolidated financial statements and the notes to those statements for the year ended September 30, 2018 which were filed with the Securities and Exchange Commission on January 14, 2019.

Comparison of the results of operations for the quarter ended December 31, 2018 compared to the quarter ended December 31, 2017

Revenues

For the quarters ended December 31, 2018 and 2017, revenue was as follows:

		2018		2017
Revenues	$	337,952	$	309,829
Net (loss)	$	(4,019,599)	$	(687,843)
Basic and diluted earnings (loss) per share	$	(0.48)	$	(0.10)

For the quarter December 31, 2018, total revenues amounted to $337,952 as compared to $309,829 for the quarter ended December 31, 2017, an increase of $28,123 or 9.0%. This increase in revenues was primarily comprised of straight lining the rent we expect from our other three leases. Under US GAAP, our rental income from the properties is earned on a straight-line basis over the entire expected life of the rent agreement, including the free rent period we have provided until each lessor ends its cannabis growing season. As of December 31, 2018, only the Willamette Property lessor had begun cash payments under the lease. We expect the remaining three lessors to commence cash payments under their three leases after completion of the property buildouts which will estimate will be in March 2019. Should we be successful in acquiring the companies that are currently our renters, our revenues will change to those of direct cannabis operations.

Operating expenses

		Quarter Ended December 31, 2018		Quarter Ended December 31, 2017
Consulting fees	$	74,350	$	55,450
Professional fees	$	441,872	$	140,598
General and administrative expenses	$	858,782	$	432,368
Stock based compensation	$	1,600,577	$	359,546
Total	$	2,975,581	$	987,962

- For the quarter ended December 31, 2018, consulting fees increased by $18,900, or 34.1%, as compared to the quarter ended December 31, 2017 due to an increase in the execution of additional consulting contracts in the area of investor relations.

- For the quarter ended December 31, 2018, professional fees increased by $301,274, or 214.3%, as compared to the quarter ended December 31, 2017. The increase was primarily attributable to both legal and accounting fees relative to compliance, acquisitions and our audit. We expect these fees to increase as we continue to grow and acquire additional operations in future periods.

- General and administrative expenses consist of expenses such as rent expense, directors' and officers' liability insurance, travel expenses, office expenses, telephone and internet expenses and other general operating expenses. For the quarter ended December 31, 2018, general and administrative expenses increased by $426,414 or 98.6% as compared to the quarter ended December 31, 2017. These increases were primarily attributable to an increase in insurance, depreciation, and salary expense. We expect these fees to increase as we continue to grow and acquire additional operations in future periods.

- During the quarter ended December 31, 2018, we recorded stock-based compensation of $1,600,577 as compared to $359,546 for the comparable 2017 period, an increase of $1,241,031 or 345.2%. This increase is due to the hiring of new consultants and additional compensation for officers and directors. We expect to continue in the short term of relying on equity to pay for a significant portion of the costs of consultants, employees and directors, so that we can concentrate on using our available cash resources to buildout and grow our business.

Operating loss

As a result of the factors described above, for the quarters ended December 31, 2018 and 2017, operating loss amounted to $4,019,599, as compared to an operating loss of $687,843, an increase of $3,331,756 or 484.4%.

Other income (expenses)

Other income (expenses) primarily includes interest expense incurred on debt, and also includes other income (expenses). For the quarter ended December 31, 2018, total other income, amounted to a net expense of $1,381,970, as compared to total other income of $9,710, representing a change of $1,372,360 or 14132.4%. During the quarter ended December 31, 2018, interest expense increased by $548,356 which is attributable to interest only mortgages procured in this period. Additionally, Inducement cost incurred was $823,900 as compared to no expense as of the prior period. We do not expect at this time for inducement costs to recur, as those costs were associated with our incentive to holders of our then short term, 6 month and 12 month convertible notes to convert those notes, as we were in the process of raising funds under our new Unit offering, and we deemed it more likely to succeed at the time, should we incentivize the prior convertible note holders to convert their notes.

Net income (loss)

As a result of the foregoing, for the quarters ended December 31, 2018 and 2017, net loss amounted to $4,019,599, or $(0.29) per common share, and a net loss of $687,843, or $(0.10) per common share, respectively.

LIQUIDITY AND FINANCIAL CONDITION

Liquidity and Capital Resources

The Company had cash of $3,794,090 and $2,179,017 as of December 31, 2018 and 2017 respectively. Our primary uses of cash have been for salaries, fees paid to third parties for professional services, insurance, general and administrative expenses, and the acquisitions and development of rental properties. All funds received have been expended in the furtherance of growing the business. We have received funds from financing activities such as from debt financing as well as the proceeds from advances to be contributed from venture. The following trends are reasonably likely to result in changes in our liquidity over the near to long term:

- An increase in working capital requirements to finance our current business,
- Acquisition and buildout of rental properties;
- Addition of administrative and sales personnel as the business grows and
- The cost of being a public company.

Subsequent to December 31, 2018, we have not raised an additional funds in our private placements, however have raised C$2,141,000 (approximately $1.4 mm in USD) in convertible debt financing. Our efforts to raise additional capital are ongoing and we expect to close in the following quarters on the remaining approximately C$7 million available under the Unit offering.

We currently have committed that we would need to spend approximately $150,000 thousand on capital expenditures for the expansion and buildout of our Mulino, Powell and Springfield properties. These capital expenditures are contingent upon several factors including the Company obtaining financing for the development of the properties and the construction of the tenant improvements in such amount and on such terms and provisions as are acceptable to the Company.

We have used our available funds to fund our operating expenses, pay our obligations, acquire and develop rental properties, and grow our company. We need to raise significant additional capital or debt financing to acquire new properties, to develop existing properties, and to assure we have sufficient working capital for our ongoing operations and debt obligations. There is no guarantee that such funding will be available to the Company at a viable cost, if at all.

Equipment financing

In November 2017, the Company entered into a promissory note in the amount of $21,749 from a vendor of the Company to finance the acquisition of a security electronics system in one of its properties. The promissory note bears an interest rate of 18% per annum and also contains a 10% servicing fee. The note matures 24 months after issuance and is secured by certain security electronics purchased with proceeds of the note. This vendor is currently in a restructuring and is likely to go out of business. As of December 31, 2018, the Company has been notified that the vendor holding the note is in bankruptcy and during the quarter ended December 31, 2018, the Company withheld payment under the note. The obligation remains outstanding at $14,950 as of December 31, 2018.

Effective April 29, 2018, the Company entered into a 36-month premium finance agreement in consideration for a John Deere Gator Tractor in the principal amount of $15,710. The note bears no annual interest rate and requires the Company to make thirty-six monthly payments of $442 over the term of the note. As of December 31, 2018, the obligation outstanding is $12,389. No amount was recorded for the premium for the non-interest bearing feature of the note as it was immaterial. The note is secured by the equipment financed.

Effective May 29, 2018, the Company entered into a 24-month premium finance agreement in consideration for a MT85 wide track loader in the principal amount of $27,844. The note bears no annual interest rate and requires the Company to make 24 monthly payments of $1,160 over the term of the note. As of December 31, 2018, the obligation outstanding is $20,883. No amount was recorded for the premium for the non-interest bearing feature of the note as it was immaterial. The note is secured by the equipment financed.

Due to related parties

As of December 31, 2018, related parties had advanced cash and equipment, on a due on demand, unsecured and undocumented basis, to the Company in the amount of $33,600.

Insurance financing

Effective July 31, 2018, the Company entered into a 9-month premium finance agreement in partial consideration for an insurance policy in the principal amount of $54,701.55. The note bears an annual interest rate of 7.99% and requires the Company to make nine monthly payments of $4,435 over the term of the note. As of December 31, 2018, the obligation outstanding is $17,741.

Short term notes and advances

In September 2018, an investor interested in the then ongoing private placement of convertible notes (see below) advanced the Company $168,000 on an unsecured basis and then entered discussions with Company regarding the form of the note. As of December 31, 2018, the Company and the investor had not come to terms and the investor did not agree to the terms of the notes. The Company has treated the amount as an unsecured advance, due on demand. As of December 31, 2018 and the date of these financial statements, no demand had been made and the Company continues to negotiate with the investor.

In November 2018, a board member of the Company and several outside investors provided the Company with approximately $3.493 million in cash to be dispensed to an entity being setup by the investors with assistance from the Company, and which has yet to open a checking account, which will be primarily owned and controlled by the board member, upon that entity completing its setup and opening up of a checking account. The Company is currently treating the amounts tendered as undocumented advances, due on demand and non-interest bearing. The Company expects that the new venture will be setup in the near term and has therefore not recorded a premium or discount associated with the funds advanced as they would be immaterial.

In connection with the proposed investment in East Coast Packers, LLC (“ECP”), the Company entered into a promissory note in the principal amount of $1 million payable to ECP as part of its investment in the LLC. The promissory is payable in five installments commencing upon the effective date (the date of grant of license to engage in cannabis operations issuable by the government of the State of Florida), over the course of 1 year, with an interest rate of 1% per annum for the first six months, then increasing to 5.5% per annum for the remainder of the note period through maturity. In the event the LLC is denied the licenses necessary to operate, the note is cancelled in full.

Mortgages payable

On February 28, 2018, the Company executed a $550,000 mortgage payable on the Willamette property to acquire additional funds. The mortgage bears interest at 15% per annum. Monthly interest only payments began March 1, 2018 and continue each month thereafter until paid. The entire unpaid balance is due on March 1, 2020, the maturity date of the mortgage, and is secured by the underlying property. The Company paid costs of approximately $28,000 to close on the mortgage. The mortgage terms do not allow participations by the lender in either the appreciation in the fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project. The note has been cross guaranteed by the CEO and Director of the Company.

On April 4, 2018, the Company executed a $314,000 mortgage payable on the Powell property to acquire additional funds. At closing $75,000 of the proceeds was put into escrow. The mortgage bears interest at 15% per annum. Monthly interest only payments began May 1, 2018 and continue each month thereafter until paid. The entire unpaid balance is due on April 1, 2020, the maturity date of the mortgage, and is secured by the underlying property. The Company plaid costs of approximately $19,000 to close on the mortgage. The mortgage terms do not allow participations by the lender in either the appreciation in the fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project. The note has been cross guaranteed by the CEO and Director of the Company.

On January 16, 2018 the Company consummated a “Contract for Sale” for a Farm Property in Mulino OR (the “Mulino Property”). The purchase price was $1,700,000 which was reduced by a rental credit of approximately $135,000 which is equivalent to nine months’ rent at $15,000 a month and an additional credit of $9,500 for additional work done on the property. In connection with the purchase of the property, the Company made a cash payment as down payment plus payment of closing costs in the amount of $370,637 and issued a promissory note in the amount of $1,200,000 with a maturity of January 2020. The Company will pay monthly installments of principal and interest (at a rate of 2% per annum) in the amount of $13,500, commencing in July 2018 through the maturity date (January 2020), at which time the entire unpaid principal balance and any remaining accrued interest shall be due and payable in full. No amount was recorded for the premium for the below market rate feature of the note as it was immaterial. The note is secured by a deed of trust on the property. The Company performed an analysis and determined that the rate obtained was below market, however, no premium was recorded as the Company determined it was immaterial.

On December 27, 2018, the Company entered into an Agency Agreement with respect to a private offering of up to 10,000 special warrants of the Company (the “CD Special Warrants”) for aggregate gross proceeds of up to $10,000,000 (in Canadian funds, denoted herein as “C”) (the “Offering”). In addition, on December 27, 2018, the Company closed the first tranche of the Offering consisting of 3,121 CD Special Warrants at a price of C$1,000 per CD Special Warrant for aggregate gross proceeds of C$3,121,000.

Each CD Special Warrant will be exchanged (with no further action on the part of the holder thereof and for no further consideration) for one convertible debenture unit of the Company (a “Convertible Debenture Unit”), on the earlier of: (i) the third business day after the date on which both (A) a receipt (the “Receipt”) for a (final) prospectus (the “Qualification Prospectus”) qualifying the distribution of the Convertible Debentures (as defined below) and Warrants (as defined below) issuable upon exercise of the CD Special Warrants has been issued by the applicable securities regulatory authorities in the Canadian jurisdictions in which purchasers of the CD Special Warrants are resident (the “Canadian Jurisdictions”), and (B) a registration statement (the “Registration Statement”) registering the resale of the common shares underlying the Convertible Debentures and Warrants has been declared effective by the U.S. Securities and Exchange Commission (the “Registration”); and (ii) the date that is six months following the closing of the Offering. The Company has also provided certain registration rights to purchasers of the CD Special Warrants.

Each Convertible Debenture Unit is comprised of C$1,000 principal amount 8.0% senior unsecured convertible debenture (each, a "Convertible Debenture") of the Company and 167 common share purchase warrants of the Company (each, a "Warrant"). Each Warrant entitles the holder to purchase one common share of the Company (each, a "Warrant Share") at an exercise price of C$3.90 per Warrant Share for a period of 24 months following the closing of the Offering.

The Company has agreed to use its best efforts to obtain the Receipt and Registration within six months following the closing of the Offering. In the event that the Receipt and Registration have not been obtained on or before 5:00 p.m. (PST) on the date that is 120 days following the closing of the Offering, each unexercised CD Special Warrant will thereafter entitle the holder thereof to receive, upon the exercise thereof and at no additional cost, 1.05 Convertible Debenture Units per CD Special Warrant (instead of 1.0 Convertible Debenture Unit per CD Special Warrant). Until the Receipt and Registration have been obtained, securities issued in connection with the Offering (including any underlying securities issued upon conversion or exercise thereof) will be subject to a 6-month hold period from the date of issue.

The brokered portion of the Offering (C$2,247,000) was completed by a syndicate of agents (collectively, the "Agents"). The Company paid the Agents a cash commission equal to 7.0% of the gross proceeds raised in the first tranche of the brokered portion of the Offering. As additional consideration, the Company issued the Agents such number of non-transferable broker convertible debenture special warrants (the "**Broker CD Special Warrants**") as is equal to 7.0% of the number of CD Special Warrants sold under the first tranche of the brokered portion of the Offering. Each Broker CD Special Warrant shall be exchanged, on the same terms as the CD Special Warrants, into broker warrants of the Company (the "**Broker Warrants**"). Each Broker Warrant entitles the holder to acquire one Convertible Debenture Unit at an exercise price of C$1,000, until the date that is 24 months from the closing date of the Offering. The distribution of the Broker Warrants issuable upon the exchange of the Broker CD Special Warrants shall also be qualified under the Qualification Prospectus and the resale of the common shares underlying the Broker Warrants will be registered under the Registration Statement. The Company also paid the lead agent a corporate finance fee equal to C$100,000, payable as to C$50,000 in cash and as to $50,000 in common shares of the Company at a price per share of C$3.00.

Cash Flow

For the quarters ended December 31, 2018 and 2017

Net cash flows used in operating activities was $634,961 for the quarter ended December 31, 2018 as compared net cash flow used in operating activities to $505,430 for the quarter ended December 31, 2017, a change of $129,531.

- Net cash flow used in operating activities for the quarter ended December 31, 2018 primarily reflected a net loss of $4,019,599 adjusted for the add-back of non-cash items consisting of depreciation and amortization of $221,282, stock-based compensation expense of $1,600,575, non-cash interest $382,896 and convertible notes inducement expense of $823,900 offset by a change operating assets and liabilities consisting of an increase in deferred revenue of $324,152, a decrease in prepaid expenses of $207,012 and net changes in other operating liabilities of $473,124.

- Net cash flow used in operating activities for the quarter ended December 31, 2017 primarily reflected a net loss of $687,843 adjusted for the add-back of non-cash items consisting of depreciation and amortization of $75,688, stock-based compensation expense of $359,546, non-cash interest $3,854 offset by a change operating assets and liabilities consisting of an increase in deferred revenue of $282,229, a decrease in prepaid expenses of $77,658 and net changes in other operating liabilities of $52,104.

- Net cash flow used in investing activities for the quarter ended December 31, 2018 amounted to $803,163 and consisted of 467,523 used in the development of leased properties including the expansion of rentable space, upgrading irrigation, ventilation, plumbing and electrical systems, and the purchase of property and equipment. Additionally, $300,703 was invested into North Las Vegas facility.

- Net cash provided by financing activities was $4,470,863 for the quarter ended December 31, 2018 as compared to $2,823,730 for the quarter ended December 31, 2017. During the quarter ended December 31, 2018, we received proceeds from an advance from NVDRE of $300,000 and proceeds of $3,493,055 from Stem Venture Funds. Additionally, convertible debt proceeds of $735,000, note payable proceeds of $150,000, and offsets of $121,641 of payment on notes payable and $85,551 incurred for loan fee's.

CRITICAL ACCOUNTING POLICIES

Principals of Consolidation

The accompanying consolidated financial statements include the accounts of Stem Holdings, Inc. and its wholly-owned subsidiaries, Stem Group Oklahoma, Inc., Stem Holdings Florida, Inc., Stem Holdings Oregon, Inc., Stem Holdings IP, Inc., Opco, LLC, and Stem Agri, LLC. All material intercompany accounts, transactions, and profits have been eliminated in consolidation. Our wholly owned subsidiaries had no operations, assets or liabilities as of December 31, 2018.

Revenue Recognition

The Company recognizes rental revenue from tenants, including rental abatements, lease incentives and contractual fixed increases attributable to operating leases, on a straight-line basis over the term of the related leases when collectability is reasonably assured.

The Company makes estimates of the collectability of its tenant receivables related to base rents, straight-line rent and other revenues. In the current fiscal year, the Company began significant rental operations. The Company considers such things as historical bad debts, tenant creditworthiness, current economic trends, facility operating performance, lease structure, developments relevant to a tenant's business, and changes in tenants' payment patterns in its analysis of accounts receivable and its evaluation of the adequacy of the allowance for doubtful accounts. Specifically, for straight-line rent receivables, the Company's assessment includes an estimation of a tenant's ability to fulfill its rental obligations over the remaining lease term.

Real Estate Acquisition Valuation

All assets acquired and liabilities assumed in an acquisition of real estate are measured at their acquisition date fair values. The acquisition value of land, building and improvements are included in real estate investments on the accompanying consolidated balance sheets. Acquisition pursuit costs associated with asset acquisitions are capitalized. The Company has early adopted ASU 2017-01, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as businesses acquisitions. As a result of early adopting ASU 2017-01, real estate acquisitions did not meet the definition of a business combination and were deemed asset acquisitions, and the Company therefore capitalized its acquisition pursuit costs associated with these acquisitions.

Use of estimates

The preparation of these financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Estimates and judgments used are based on management's experience and the assumptions used are believed to be reasonable given the circumstances that exist at the time the financial statements are prepared. The significant estimates included in these financial statements are those associated with the assumptions used to value equity instruments, valuation of its properties for impairment testing and the deferral of rents. Actual results may differ from these estimates.

Carrying value, recoverability and impairment of long-lived assets

The Company follows Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC') 360 to evaluate its long-lived assets with determinate lives. The Company's long-lived assets, which include property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company does not test for impairment in the year of acquisition of properties so long as those properties are acquired from unrelated third parties. The Company assesses the recoverability of its long-lived assets by comparing the projected undiscounted net cash flows associated with the related long-lived asset or group of long-lived assets over their remaining estimated useful lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets. Fair value is generally determined using the assets expected future discounted cash flows or market value, if readily determinable. If long- lived assets are determined to be recoverable, but the newly determined remaining estimated useful lives are shorter than originally estimated, the net book values of the long-lived assets are depreciated and amortized over the newly determined remaining estimated useful lives.

The Company considers the following to be some examples of important indicators that may trigger an impairment review: (i) significant under-performance or losses of assets relative to expected historical or projected future operating results; (ii) significant changes in the manner or use of assets or in the Company's overall strategy with respect to the manner or use of the acquired assets or changes in the Company's overall business strategy; (iii) significant negative industry or economic trends; (iv) increased competitive pressures; (v) a significant decline in the Company's stock price for a sustained period of time; and (vi) regulatory changes. The Company evaluates assets for potential impairment indicators at least annually and more frequently upon the occurrence of such events.

Capitalization of Project Costs

The Company's policy is to capitalize all costs that are directly identifiable with a specific property, would be capitalized if the Company had already acquired the property, and when the property, or an option to acquire the property, is being actively sought after, and either funds are available or will likely become available in order to exercise their option. All amounts shown capitalized prior to acquisition of a property are included under the caption of Project Costs in the balance sheet.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and is depreciated using the straight-line method over the assets' estimated useful life as follows:

Buildings	20 years
Leasehold improvements	Shorter of term of lease or economic life of improvement
Furniture and equipment	5 years
Signage	5 years
Software and related	5 years

Normal maintenance and repairs for equipment are charged to expense as incurred, while significant improvements are capitalized.